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SECURITIES AND EXCHANGE COMMISSION  
[Release No. 34-73415; File No. SR-MSRB-2014-06]

October 23, 2014

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, Consisting of Proposed New Rule G-44, on Supervisory and Compliance Obligations of Municipal Advisors; Proposed Amendments to Rule G-8, on Books and Records to be Made by Brokers, Dealers and Municipal Securities Dealers; and Proposed Amendments to Rule G-9, on Preservation of Records

I. Introduction

On July 24, 2014, the Municipal Securities Rulemaking Board (the “MSRB” or “Board”) filed with the Securities and Exchange Commission (the “SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change consisting of proposed new Rule G-44, on supervisory and compliance obligations of municipal advisors and proposed amendments to Rule G-8, on books and records to be made by brokers, dealers and municipal securities dealers, and proposed amendments to Rule G-9, on preservation of records. The proposed rule change was published for comment in the Federal Register on August 5, 2014.<sup>3</sup>

The Commission received eight comment letters on the proposal.<sup>4</sup> On October 17, 2014,

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 72706 (July 29, 2014) (the “Proposing Release”), 79 FR 45546 (August 5, 2014).

<sup>4</sup> See Letters to Secretary, Commission, from Tamara K. Salmon, Senior Associate Counsel, Investment Company Institute (“ICI”), dated August 19, 2014 (the “ICI Letter”); David L. Cohen, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association (“SIFMA”), dated August 21, 2014 (the “SIFMA

the MSRB responded to the comments<sup>5</sup> and filed Amendment No. 1 to the proposed rule change.<sup>6</sup> The Commission is publishing this notice to solicit comments on Amendment No. 1 to the proposed rule change from interested persons and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

## II. Description of the Proposed Rule Change

As further described in the Proposing Release, the MSRB states that the purpose of the proposed rule change is to establish supervisory and compliance obligations of municipal advisors when engaging in municipal advisory activities. Proposed Rule G-44 utilizes a primarily principles-based approach to supervision and compliance in order to, among other things, accommodate the diversity of the municipal advisor population, including small and

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Letter”); Dave A. Sanchez (“Sanchez”), dated August 25, 2014 (the “Sanchez Letter”); Michael Nicholas, Chief Executive Officer, Bond Dealers of America (“BDA”), dated August 26, 2014 (the “BDA Letter”); Anonymous Attorney, dated August 26, 2014 (the “Anonymous Attorney Letter”); Nathan R. Howard, Counsel, National Association of Independent Public Finance Advisors (“NAIPFA”), dated August 26, 2014 (the “NAIPFA Letter”); Cristeena G. Naser, Vice President, American Bankers Association (“ABA”), dated August 26, 2014 (the “ABA Letter”); and Joshua Cooperman, Cooperman Associates (“Cooperman”), dated August 30, 2014 (the “Cooperman Letter”).

<sup>5</sup> See Letter to Secretary, Commission, from Michael L. Post, Deputy General Counsel, MSRB, dated October 17, 2014 (the “MSRB Response Letter”), available at <http://www.sec.gov/comments/sr-msrb-2014-06/msrb201406-9.pdf>.

<sup>6</sup> See Letter to Secretary, Commission, from Michael L. Post, Deputy General Counsel, MSRB, dated October 17, 2014 (the “MSRB Amendment Letter”), available at <http://www.sec.gov/comments/sr-msrb-2014-06/msrb201406-10.pdf>. In Amendment No. 1, the MSRB partially amended the text of the original proposed rule change to (i) revise paragraphs .01 and .02 of the Supplementary Material to Rule G-44 to expand the applicability of the provision, requiring a municipal advisor’s written supervisory procedures to address how its supervision is adequate even without having separate supervisors, to account for instances of self-supervision that may occur in firms that are not sole proprietorships; (ii) amend the text of Rule G-44(e) to reference Rule G-8(h)(v)(A)-(E) rather than Rule G-8(h)(iii); and (iii) amend the text of Rule G-9(k) to reference Rule 15Ba1-8(d) under the Act rather than Rule 15a1-8(d) under the Act.

single-person entities. Proposed Rule G-44 is accompanied by proposed amendments to Rules G-8 and G-9 to establish fundamental books-and-records requirements for municipal advisors, including those related to their supervisory and compliance obligations.<sup>7</sup>

#### Proposed Rule G-44

In the Proposing Release, the MSRB stated that proposed Rule G-44 follows a widely accepted model in the securities industry consisting of a reasonably designed supervisory system complemented by the designation of a chief compliance officer (“CCO”). The proposed rule draws on aspects of existing supervision and compliance regulation under other regimes, including those for broker-dealers under rules of the MSRB and Financial Industry Regulatory Authority (“FINRA”) and for investment advisers under the Investment Advisers Act of 1940 (“Advisers Act”).<sup>8</sup>

In summary, proposed Rule G-44 would require:

- A supervisory system reasonably designed to achieve compliance with applicable securities laws;
- Written supervisory procedures;
- The designation of one or more municipal advisor principals to be responsible for supervision;
- Compliance processes reasonably designed to achieve compliance with applicable securities laws;
- An annual certification regarding those compliance processes;
- The designation of a CCO to administer those compliance processes; and

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<sup>7</sup> See supra note 3.

<sup>8</sup> Id.

- At least annual reviews of compliance policies and supervisory procedures.

The proposed amendments to Rules G-8 and G-9, in summary, would require each municipal advisor to make and keep records of its:

- Written supervisory procedures;
- Designations of persons as responsible for supervision;
- Written compliance policies;
- Designations of persons as CCO;
- Reviews of compliance policies and supervisory procedures; and
- Annual certifications regarding compliance processes.

Paragraph (a) of proposed Rule G-44 is the core provision, which would require all municipal advisors to establish, implement and maintain a system to supervise their municipal advisory activities and those of their associated persons that is reasonably designed to achieve compliance with all applicable securities laws and regulations, including applicable MSRB rules (defined as “applicable rules”). Paragraph (a) specifies that final responsibility for proper supervision rests with the municipal advisor. Subparagraph (a)(i) requires the establishment, implementation, maintenance and enforcement of written supervisory procedures reasonably designed to achieve compliance with applicable rules. Paragraph .01 of the Supplementary Material specifies several factors that municipal advisors’ written supervisory procedures must take into consideration, including the advisor’s size, organizational structure, nature and scope of activities, number of offices, disciplinary and legal history of its associated persons, the likelihood that associated persons may be engaged in relevant outside business activities, and any indicators of irregularities or misconduct (i.e., “red flags”). This guidance allows municipal advisors to tailor their supervisory procedures to, among other things, their size, particular business model and

structure. Paragraph .01 also requires in the case of a municipal advisor with any associated persons permitted under all applicable law to supervise their own activities, the written supervisory procedures must address the manner in which, in the absence of separate supervisory personnel, such procedures are nevertheless reasonably designed to achieve compliance with applicable rules.<sup>9</sup> Paragraph .02 of the Supplementary Material emphasizes the flexibility of the proposed rule to accommodate small municipal advisor firms, even those with only one associated person. Proposed Rule G-44(a)(i) also specifies requirements to promptly amend supervisory procedures (i) to reflect changes in applicable rules and (ii) as changes occur in the municipal advisor's supervisory system; and to communicate the procedures and amendments to the municipal advisor's relevant associated persons.

Proposed Rule G-44(a)(ii) would require municipal advisors to designate one or more municipal advisor principals to be responsible for the supervision required by the proposed rule. Paragraph .03 of the Supplementary Material specifies the authority and specific qualifications required for municipal advisor principals designated as responsible for supervisory functions. According to the proposed rule, they must have the authority to carry out the supervision for which they are responsible, including the authority to implement the municipal advisor's established written supervisory procedures and take any other action necessary to fulfill their responsibilities. They also must have sufficient knowledge, experience and training to understand and effectively discharge their supervisory responsibilities.<sup>10</sup> Paragraph .03 of the Supplementary

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<sup>9</sup> See supra note 6.

<sup>10</sup> The MSRB intends to propose amendments to MSRB Rules G-2 and G-3 to create the "municipal advisor principal" classification, define the term and require qualification in accordance with the rules of the Board. The MSRB expects those changes to become effective well in advance of the proposed implementation dates of the proposed rule change. Although the MSRB does not expect a municipal advisor principal examination to

Material also specifies that, even if not designated as a supervisory principal, whether a person has responsibility for supervision under the proposed rule would depend on whether, under the facts and circumstances of a particular case, the person has the requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue.

Paragraph (b) of proposed Rule G-44 would require municipal advisors to implement processes to establish, maintain, review, test and modify written compliance policies and supervisory procedures. Proposed Rule G-44(b) would specify that the reviews of compliance policies and supervisory procedures must be conducted at least annually. Paragraph .04 of the Supplementary Material would provide, however, that municipal advisors should consider the need, in order to comply with all of the other requirements of the proposed rule, for more frequent reviews. The paragraph also would provide guidance on what, at a minimum, municipal advisors should consider during their reviews of compliance policies and supervisory procedures. These considerations include any compliance matters that arose since the previous review, any changes in municipal advisory activities and any changes in applicable law.

Paragraph (c) of proposed Rule G-44 would require municipal advisors to designate one individual as their CCO. Paragraph .05 of the Supplementary Material would explain the role of a CCO and the importance of that role. Specifically, a CCO is a primary advisor to the municipal advisor on its overall compliance scheme and the policies and procedures that the municipal advisor adopts in order to comply with applicable law. To fulfill this role, a CCO should have competence in the process of (1) gaining an understanding of the services and activities that need to be the subject of written compliance policies and written supervisory procedures; (2)

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be in place by the time of the implementation dates of the proposed rule change, the MSRB may develop such an examination in the future. The absence of such an examination does not preclude the creation of the classification.

identifying the applicable rules pertaining to those services and activities; (3) developing policies and procedures that are reasonably designed to achieve compliance with applicable law; and (4) developing programs to test compliance with the municipal advisor's policies and procedures.<sup>11</sup>

Paragraph .05 would further explain that the CCO can be a principal of the firm or a person external to the firm; though, in that case, the person must have the described competence and the municipal advisor retains ultimate responsibility for its compliance obligations. This approach to the CCO function in the proposed rule, which would give municipal advisors the option to outsource the CCO role, follows the approach applicable to investment advisers under the Advisers Act.<sup>12</sup>

Paragraph .06 of the Supplementary Material specifies that the CCO, and any compliance officers that report to the CCO, shall have responsibility for and perform the compliance functions required by the proposed rule. Paragraph .07 of the Supplementary Material provides that a municipal advisor's CCO may hold any other position within the municipal advisor, including senior management positions, so long as the person can discharge the duties of CCO in light of all of the responsibilities of any other positions. This guidance is especially relevant to small municipal advisors, including sole proprietorships and other one-person entities. It makes clear that a single individual may, for example, serve under appropriate circumstances as chief executive officer ("CEO"), supervisory principal and CCO. In addition, as discussed above, the CCO may be external to the firm, such as an outside consultant.

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<sup>11</sup> These qualifications of a CCO draw on those specified in FINRA's CCO requirement for its member firms. See FINRA Rule 3130 Supplementary Material .05.

<sup>12</sup> See Section 202(25) of the Advisers Act, 15 U.S.C. 80b-2(25), and Rule 206(4)-7, 17 CFR 275.206(4)-7.

Paragraph (d) of proposed Rule G-44 would require municipal advisors to have their CEO(s) (or equivalent officer(s)) annually certify in writing that the municipal advisor has in place processes to establish, maintain, review, test and modify written compliance procedures and written supervisory procedures reasonably designed to achieve compliance with applicable rules. FINRA member firms that also are municipal advisors are already required under FINRA Rule 3130 to make annually a substantially similar certification with respect to applicable federal securities laws and regulations, including MSRB rules. In light of this existing FINRA requirement, proposed Rule G-44(d) would provide for an exception from the annual certification requirement for municipal advisors that are subject to a substantially similar FINRA requirement. Paragraph .08 of the Supplementary Material provides that the execution of the certification and any consultation rendered in connection with the certification does not by itself establish business line responsibility.

Paragraph (e) of proposed Rule G-44 would provide an exemption for banks engaging in municipal advisory activities in the exercise of bank fiduciary powers from Rule G-44 and the related books and records requirements if the municipal advisor certifies in writing annually that it is, with respect to those activities, subject to federal supervisory and compliance obligations and books and record requirements that are substantially equivalent to the supervisory and compliance obligations in Rule G-44 and the books and records requirements of Rule G-8(h)(v)(A)-(E). The ability to so certify and utilize this exemption is provided because it is unnecessary for a municipal advisor to comply with each other provision of proposed Rule G-44 if it is subject to substantially equivalent supervisory and compliance obligations as part of the extensive federal regulatory regime to which banks are already subject.



Paragraph (f) of proposed Rule G-44 would provide a definition of the term “municipal advisor” for purposes of the rule as a person that is registered or required to be registered as a municipal advisor under Section 15B of the Act and rules and regulations thereunder.

#### Proposed Amendments to Rules G-8 and G-9

The proposed amendments to Rules G-8<sup>13</sup> and G-9 would be the first revisions to those rules to address the books and records that must be made and preserved by municipal advisors registered or required to be registered with the SEC. As a fundamental element, new Rule G-8(h)(i) would require each municipal advisor to keep all of the general business records described in Exchange Act Rule 15Ba1-8(a)(1)-(8). New Rule G-8(h)(v) would require each municipal advisor to make and keep records related to its supervisory and compliance obligations. It would require each municipal advisor to make and keep its written supervisory procedures and written compliance policies, records of designations of persons as CCO and of persons responsible for supervision, records of reviews of its written compliance policies and written supervisory procedures, annual certifications as to compliance processes, and, if applicable, certifications regarding the exemption for federally regulated banks.

The proposed amendments to Rule G-9 would require each municipal advisor to preserve the books and records described in Rule G-8(h), including records related to the municipal advisor’s supervisory and compliance obligations, for a period of not less than five years. This five-year preservation requirement would be consistent with the requirement of Exchange Act

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<sup>13</sup> Proposed Rule G-8(h) includes reserved subparagraphs (ii) - (iv) for books and records provisions that the MSRB may propose in relation to other rules for municipal advisors. The MSRB will make conforming changes to this proposal as appropriate depending on relevant future rulemaking actions by the MSRB and SEC.

Rule 15Ba1-8 (on books and records to be made and maintained by municipal advisors).<sup>14</sup> New subsection (h) to Rule G-9 would require, however, that records of the designations of persons responsible for supervision and designations of persons as CCO be preserved for the period of designation of each person designated and for at least six years following any change in such designation. This six-year preservation requirement is supported by, among other things, the importance of such documents in later ascertaining the identity of responsible persons during particular periods of time. Moreover, it would be consistent with the current provisions of Rule G-9 for records of similar designations by brokers, dealers and municipal securities dealers.

The proposed amendments to existing Rule G-9(e) would expressly provide that municipal advisors may retain records using electronic storage media or by other similar medium of record retention, subject to the retrieval and reproduction requirements of Rule G-9. The allowance for this means of compliance would be made generally applicable, so as to expressly accommodate the use of electronic storage media by dealers as well as municipal advisors.

Proposed Rule G-9(i) would require compliance with Exchange Act Rule 15Ba1-8(b)(2) and (c),<sup>15</sup> regarding records related to the formation and cessation of business. Proposed Rule G-9(j) would require non-resident municipal advisors to comply with Exchange Act Rule 15Ba1-8(f),<sup>16</sup> regarding records of non-resident municipal advisors. Proposed Rule G-9(k) would provide that whenever a record is preserved by a municipal advisor on electronic storage media, if the manner of storage complies with Exchange Act Rule 15Ba1-8(d),<sup>17</sup> it will be deemed to be

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<sup>14</sup> See 17 CFR 240.15Ba1-8(b)(1).

<sup>15</sup> 17 CFR 240.15Ba1-8(b)(2) & (c).

<sup>16</sup> 17 CFR 240.15Ba1-8(f).

<sup>17</sup> 17 CFR 240.15Ba1-8(d).

preserved in a manner that is in compliance with the requirements of Rule G-9. This provision would give municipal advisors the choice to comply with either the SEC's or the MSRB's preservation requirements.

### III. Summary of Comments Received and the MSRB's Response

As noted previously, the Commission received eight comment letters on the proposed rule change and a response letter from the MSRB.<sup>18</sup> The commenters generally support the proposed rule change.<sup>19</sup> However, some commenters asked for further clarification and provided suggestions to the proposed rule change.<sup>20</sup> The MSRB has responded to the commenters, as discussed below.<sup>21</sup>

#### 1. Flexibility for Small Municipal Advisors

BDA commented that proposed Rule G-44 provides too much flexibility for small firms by allowing them to determine and make accommodations for themselves simply because of their size, and that those accommodations should be circumscribed.<sup>22</sup> Alternatively, Cooperman commented that the proposed Rule G-44 imposes regulatory burdens on small municipal advisors and particularly sole proprietors that are not necessary, appropriate or logical to the protection of the municipal clients of such advisors.<sup>23</sup> NAIPFA stated that proposed Rule G-44 appropriately accommodates small and single-person municipal advisors by, among other things,

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<sup>18</sup> See supra notes 4 and 5.

<sup>19</sup> Id.

<sup>20</sup> Id.

<sup>21</sup> See MSRB Response Letter.

<sup>22</sup> See BDA Letter.

<sup>23</sup> See Cooperman Letter.

allowing supervisory systems to be tailored to the size of the firm.<sup>24</sup> However, NAIPFA suggested exempting single-person firms from developing a compliance manual to the extent such firms are not otherwise required to maintain policies pursuant to any other applicable laws.<sup>25</sup> NAIPFA also believes the imposition of supervisory obligations on sole proprietors is likely not necessary or appropriate since such individuals will be obligated to monitor their own compliance thereby making a requirement that they maintain supervisory procedures superfluous.<sup>26</sup>

Sanchez stated that compliance with proposed Rule G-44(a) and (b), paragraph .04 of the Supplementary Material and the associated recordkeeping requirements should be deemed a sufficient supervisory system for municipal advisors with a single associated person.<sup>27</sup> Sanchez suggested deleting the last sentence of paragraph .02 of the Supplementary Material, which requires that written supervisory procedures of municipal advisors with a single associated person address the manner in which, in the absence of separate supervisory personnel, such procedures are nevertheless reasonably designed to achieve compliance with applicable rules.<sup>28</sup>

In response to comments, the MSRB acknowledged that proposed Rule G-44 contains standards that may vary based on firm size and that the MSRB deliberately drafted the rule to give firms flexibility to tailor their supervisory systems accordingly, striking an appropriate

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<sup>24</sup> See NAIPFA Letter.

<sup>25</sup> Id.

<sup>26</sup> Id.

<sup>27</sup> See Sanchez Letter.

<sup>28</sup> Id.

balance between burdens on, and flexibility for, small municipal advisors.<sup>29</sup> MSRB also stated that the approach set forth in proposed Rule G-44 seems particularly appropriate for an industry in which many participants are becoming regulated at the federal level for the first time.<sup>30</sup>

With respect to paragraph .02 of the Supplementary Material, the MSRB believes this provision is important to ensuring all municipal advisors establish meaningful procedures that will satisfy the minimum standard established by proposed Rule G-44.<sup>31</sup> The MSRB stated that developing appropriate systems and documenting and following written procedures is a well-established practice among businesses, regardless of size, for facilitating compliance with regulation in a broad range of other areas (e.g., taxes, human resources). Additionally, the MSRB noted that FINRA's consolidated supervision rule (FINRA Rule 3110) includes a substantially similar requirement. Although the provision will always apply to sole proprietorships, the MSRB believes it is relevant to other firms in which associated persons may be otherwise permitted to supervise their own activities. Accordingly, the MSRB filed Amendment No. 1 to revise the rule text to expand the applicability of the requirement to all firms with associated persons who supervise their own activities.<sup>32</sup>

## 2. Annual Certification

Several comment letters addressed the proposed annual certification requirement in proposed Rule G-44. ICI supports the proposed annual certification requirement as drafted because it is consistent with the requirements imposed on FINRA members pursuant to FINRA

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<sup>29</sup> See MSRB Response Letter.

<sup>30</sup> Id.

<sup>31</sup> Id.

<sup>32</sup> See MSRB Amendment Letter.

Rule 3130(b).<sup>33</sup> Anonymous Attorney supports the exception from the annual certification for municipal advisors that are subject to FINRA Rule 3130.<sup>34</sup> While BDA supports the MSRB's effort to ensure alignment of its annual certification requirement with FINRA Rule 3130, it stated that proposed Rule G-44 should require all municipal advisors to complete a periodic self-certification regarding the meeting of professional qualification standards by its associated persons, as well as to certify to the municipal advisor's ability to comply, and history of complying, with all applicable regulatory requirements.<sup>35</sup> NAIPFA opposes any self-certification requirement, unless some objective basis can be provided that indicates such a requirement would result in a decrease in the number of compliance violations.<sup>36</sup>

Sanchez commented that the regulatory purpose of the annual certification requirement as to compliance processes in proposed Rule G-44(d) is unclear because the associated recordkeeping requirements essentially already require the equivalent of an annual certification.<sup>37</sup> In addition, Sanchez does not believe the annual certification would foster discussion between persons responsible for compliance matters and upper management, and questions whether such a provision is necessary for small municipal advisors, particularly sole proprietors, in light of Section 15B(b)(2)(L)(iv) of the Act.<sup>38</sup> Finally, Sanchez believes there would be no "harmonizing" benefit achieved by imposing the annual certification requirement

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<sup>33</sup> See ICI Letter.

<sup>34</sup> See Anonymous Attorney Letter.

<sup>35</sup> See BDA Letter.

<sup>36</sup> See NAIPFA Letter.

<sup>37</sup> See Sanchez Letter.

<sup>38</sup> Id.

similar to FINRA's requirement because the vast majority of registered municipal advisors are not FINRA members, and FINRA members would be specifically exempted from proposed Rule G-44(d).<sup>39</sup>

In response to the comments, the MSRB stated that the certification requirement would result in the creation, maintenance and modification of robust written supervisory procedures that would promote compliance with all applicable rules.<sup>40</sup> The MSRB noted that requiring the broader certification proposed by BDA would reduce the harmonization between the MSRB and FINRA certifications, which is an aspect of the proposal that BDA and ICI specifically support.<sup>41</sup> The MSRB also noted that it would be an unnecessary burden at this time to require a broader certification such as the one proposed by BDA.<sup>42</sup>

In response to Sanchez's comments, the MSRB stated that requiring each firm's chief executive officer (or equivalent officer) to provide an annual certification would help ensure that compliance processes are given sufficient attention at the highest levels of management and would help promote compliance, without adding a significant burden.<sup>43</sup> The MSRB further stated that the annual certification requirement will foster discussion between compliance personnel and upper management, as it creates accountability for, and incentivizes, the chief executive officer (or equivalent officer) to ensure that the certification is truthful and otherwise satisfies

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<sup>39</sup> Id.

<sup>40</sup> See MSRB Response Letter.

<sup>41</sup> Id.

<sup>42</sup> Id.

<sup>43</sup> Id.

proposed Rule G-44(d).<sup>44</sup> The MSRB acknowledged that the benefit from certification of fostering discussion does not exist in sole proprietorships and perhaps some very small firms, but stated that the benefits from certification can extend beyond fostering such discussion.<sup>45</sup> The MSRB believes the annual certification requirement would help ensure that municipal advisors have in place a compliance framework that would allow them to adapt compliance efforts to an evolving business and regulatory environment, and promote prompt maintenance and modification of compliance programs.<sup>46</sup> In addition, the MSRB believes this requirement includes multiple accommodations for small municipal advisors and is consistent with Section 15B(b)(2)(L)(iv) of the Act.<sup>47</sup>

### 3. Comparison to Rule G-27

Sanchez suggested replacing the proposed timing standard for amending written supervisory procedures and communicating such amendments to associated persons (i.e., “promptly”) to the standard in MSRB Rule G-27(c)(iii) (i.e., “as appropriate within a reasonable time after changes occur”).<sup>48</sup> Sanchez stated the Rule G-27 standard is more reasonable and will be less confusing for entities that are registered as both broker-dealers and municipal advisors.<sup>49</sup> Sanchez also stated the proposed standard of “prompt amendment” and “prompt

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<sup>44</sup> Id.

<sup>45</sup> Id.

<sup>46</sup> Id.

<sup>47</sup> Id.

<sup>48</sup> See Sanchez Letter.

<sup>49</sup> Id.



communication” is vague and more burdensome than the standard the MSRB requires of other regulated activities without any apparent justification.<sup>50</sup>

The MSRB responded that the provision requiring prompt amendments of written supervisory procedures and prompt communication of such amendments to associated persons is intended to harmonize proposed Rule G-44 with FINRA’s rule on the maintenance of supervisory procedures in its consolidated supervision rule.<sup>51</sup> The MSRB recognizes the proposed timing standards are different than those provided in the analogous provision in Rule G-27 and the MSRB may consider amending Rule G-27 in the future to harmonize it with proposed Rule G-44(a)(i) and the FINRA rule.

#### 4. Outsourcing CCO Function

BDA commented that the language in paragraph .05 of the Supplementary Material to proposed Rule G-44, providing that a municipal advisor retains the ultimate responsibility for its compliance obligations, whether the CCO is outsourced or not, should be incorporated into the rule text.<sup>52</sup> BDA believes some firms will take a strict reading of the rule text without appropriately considering the Supplementary Material as a component of their compliance with proposed Rule G-44.<sup>53</sup>

The MSRB responded that it is not relocating the provision into the rule text because the Supplementary Material would be part of new Rule G-44, if approved, and the provision’s location there is intended to improve the readability of the rule and does not affect the weight,

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<sup>50</sup> Id.

<sup>51</sup> See MSRB Response Letter.

<sup>52</sup> See BDA Letter.

<sup>53</sup> Id.

significance or enforceability of the provision.<sup>54</sup> Moreover, the MSRB stated that BDA's comment that some firms would not appropriately consider the Supplementary Material when reading proposed Rule G-44 is speculative in nature and, if fully accepted, could suggest a need to remove all supplementary material from the rules of the MSRB and other self-regulatory organizations.<sup>55</sup>

#### 5. Bank Trust Departments and Trust Companies

The ABA praised the MSRB's exemption in the proposed Rule G-44(e) for banks that certify they are subject to federal supervisory and compliance obligations and books and records requirements that are substantially equivalent to the supervisory and compliance obligations of proposed Rule G-44 and the books and records requirements of Rule G-8(h)(v)(A)-(E), and the ABA requested that a similar exemption be available for state-chartered trust companies.<sup>56</sup>

The MSRB responded that it would not extend the exemption of proposed Rule G-44 to bank trust departments or trust companies that are not federally regulated.<sup>57</sup> The MSRB stated that the need for proposed Rule G-44 arises from the MSRB's regulatory oversight of municipal advisors as provided under the Dodd-Frank Wall Street Reform and Consumer Protection Act,<sup>58</sup> which grants the MSRB broad rulemaking authority to develop a new, federal regulatory framework for municipal advisors.<sup>59</sup> The MSRB believes all municipal advisors should be

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<sup>54</sup> See MSRB Response Letter.

<sup>55</sup> Id.

<sup>56</sup> See ABA Letter.

<sup>57</sup> See MSRB Response Letter.

<sup>58</sup> Pub. Law No. 111-233, 124 Stat. 1376 (2010).

<sup>59</sup> See MSRB Response Letter.

required, at a minimum, to adhere to *federal* supervisory and compliance obligations that are substantially equivalent to those set forth in proposed Rule G-44, regardless of their other business activities and regulatory obligations.<sup>60</sup> MSRB noted that, as ABA acknowledges, not all states have adopted fiduciary regulations which are substantially based on the Office of the Comptroller of the Currency's ("OCC") rules and not all such state regulations are identical to the OCC's rules.<sup>61</sup> As a result of this lack of consistency between, and potential gaps in, state regulatory regimes, the MSRB stated it was not extending the exemption of proposed Rule G-44(e) to bank trust departments or trust companies that are not federally regulated with regard to relevant activities.

#### 6. Recordkeeping Requirements

SIFMA supports the proposed amendments to Rules G-8 and G-9 which it believes are reasonable and in line with existing MSRB recordkeeping and record retention requirements.<sup>62</sup> NAIPFA requested that the proposed amendments to Rule G-9(h) be amended to state that the records described in Rule G-8(h)(v)(B) and (D) shall be preserved for the duration of a person's designation as a supervisor and/or CCO and for at least five years following any change in such designation.<sup>63</sup> NAIPFA stated that establishing a six-year requirement when all other similar retention requirements are five years creates an inconsistent and overly complex regulatory regime that is not likely to achieve any appreciable benefit for municipal entities or obligated

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<sup>60</sup> Id.

<sup>61</sup> Id.

<sup>62</sup> See SIFMA Letter.

<sup>63</sup> See NAIPFA Letter.

persons.<sup>64</sup> Sanchez also suggests a five-year requirement for such records because he believes imposing a six-year period of record retention is an unnecessary complexity.<sup>65</sup>

In response to comments, the MSRB stated there is a six-year retention period for records relating to designations of persons responsible for supervision and as CCO to be consistent with the current provisions of Rule G-9 for records of similar designations by brokers, dealers and municipal securities dealers.<sup>66</sup> MSRB further stated that the longer requirement is supported by the importance of such records in ascertaining the identity of responsible persons during particular periods of time, including for purposes of examination and enforcement.<sup>67</sup>

#### 7. Requests for Clarification and Guidance

Anonymous Attorney requested clarification on three issues: (1) whether a municipal advisor and investment advisor (“MA/IA”) firm’s compliance manual must have two separate sets of written supervisory procedures for municipal advisor and investment advisor activities, and, if so, whether it would be permissible to incorporate by reference applicable existing procedures that apply to investment adviser activities, (2) whether the annual review of the municipal advisor and investment advisor compliance processes may be conducted jointly, and (3) whether a principal, designated pursuant to proposed Rule G-44(a)(ii), may be designated by title or position, instead of as a specific individual, and, if so, whether it would be acceptable to identify a principal by reference to a separate document or record.<sup>68</sup>

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<sup>64</sup> Id.

<sup>65</sup> See Sanchez Letter.

<sup>66</sup> See MSRB Response Letter.

<sup>67</sup> Id.

<sup>68</sup> See Anonymous Attorney Letter.

The MSRB responded that it used a primarily principles-based approach to proposed Rule G-44 to afford municipal advisors flexibility in determining the lowest cost means to meet regulatory objectives.<sup>69</sup> Accordingly, the MSRB believes an MA/IA firm could establish and conduct its review of written supervisory procedures and compliance policies, in the manner it deems best, and where requirements are substantially similar, referencing how the firm will comply with applicable municipal advisor and investment advisor standards may be appropriate.<sup>70</sup> However, the MSRB believes that separate written supervisory procedures for municipal advisors will need to exist given that the regulatory regimes are not identical.<sup>71</sup> The MSRB believes the flexibility of proposed Rule G-44 extends to a firm's designation of the appropriate principal(s).<sup>72</sup>

#### 8. Implementation Date

SIFMA requested no less than six months as an implementation period for proposed Rule G-44.<sup>73</sup> NAIPFA requested the proposed Rule G-44 have an effective date that is at least ninety days following the date on which it is enacted.<sup>74</sup> BDA requested that the implementation period be delayed until six months after the SEC has approved all municipal advisor rules and regulations.<sup>75</sup>

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<sup>69</sup> See MSRB Response Letter.

<sup>70</sup> Id.

<sup>71</sup> Id.

<sup>72</sup> Id.

<sup>73</sup> See SIFMA Letter.

<sup>74</sup> See NAIPFA Letter.

<sup>75</sup> See BDA Letter.

The proposed rule sets forth an implementation period of six months following the Commission's approval of the proposal except for proposed Rule G-44(d) which municipal advisors would be required to implement eighteen months after the Commission approval date. The MSRB responded that it does not intend to delay implementation of the proposed Rule G-44 until all municipal advisor rules have been approved by the SEC. Municipal advisors are currently subject to applicable federal securities laws and the MSRB believes it is important for firms to have a supervisory system and compliance processes in place to foster compliance with those laws and that can be updated as new rules are adopted.<sup>76</sup>

#### IV. Discussion and Commission Findings

The Commission has carefully considered the proposed rule change, as modified by Amendment No. 1, as well as the eight comment letters received and the MSRB's response. The Commission finds that the proposed rule change, as amended by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the MSRB.

In particular, the proposed rule change is consistent with Sections 15B(b)(2), 15B(b)(2)(A)(i) and 15B(b)(2)(C) of the Act. Section 15B(b)(2) of the Act provides that MSRB shall propose and adopt rules to effect the purposes of that title with respect to transactions in municipal securities effected by brokers, dealers, and municipal securities dealers and advice provided to or on behalf of municipal entities or obligated persons by brokers, dealers, municipal securities dealers, and municipal advisors with respect to municipal financial products, the issuance of municipal securities, and solicitations of municipal entities or obligated persons

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<sup>76</sup> See MSRB Response Letter.

undertaken by brokers, dealers, municipal securities dealers.<sup>77</sup> Section 15B(b)(2)(A)(i) of the Act provides that the MSRB’s rules shall appropriately classify municipal securities brokers, municipal securities dealers, and municipal advisors (taking into account relevant matters, including types of business done, nature of securities other than municipal securities sold, and character of business organization), and persons associated with municipal securities brokers, municipal securities dealers, and municipal advisors.<sup>78</sup> Section 15B(b)(2)(C) of the Act requires that the MSRB’s rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities and municipal financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, in general, to protect investors, municipal entities, obligated persons, and the public interest.<sup>79</sup> The proposed rule requires municipal advisors to adopt a supervisory structure and compliance processes in order to help ensure knowledge of, and compliance with, applicable securities laws and regulations, including the Commission’s registration, form submission and recordkeeping requirements for municipal advisors.<sup>80</sup> The Commission believes that supervision and compliance functions are fundamental to preventing securities law violations from occurring, and promoting early detection and prompt remediation of violations when they do occur.

The Commission also finds that the proposed rule change is consistent with Section

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<sup>77</sup> 15 U.S.C. 78o-4(b)(2).

<sup>78</sup> 15 U.S.C. 78o-4(b)(2)(A)(i).

<sup>79</sup> See 15 U.S.C. 78o-4(b)(2)(C).

<sup>80</sup> See Registration of Municipal Advisors, Rel. No. 34-70462 (Sept. 20, 2013) (“Municipal Advisor Registration Adopting Release”), 78 FR 67467 (Nov. 12, 2013).

15B(b)(2)(L)(iv), in that it does not impose a regulatory burden on small municipal advisors that is not necessary or appropriate in the public interest and for the protection of investors, municipal entities, and obligated persons.<sup>81</sup> While the proposed rule change would affect all municipal advisors, including small municipal advisors, it is a necessary and appropriate regulatory burden in order to ensure knowledge of and compliance with applicable securities laws and regulations. The proposed rule is designed to provide flexibility to small municipal advisor firms, including those with only one associated person. Paragraph .02 of the Supplementary Material provides that a municipal advisor with only one associated person can have a sufficient supervisory system under proposed Rule G-44. Under the same paragraph, one person may be designated as responsible for supervision and the rule would allow for written supervisory procedures to be tailored based on factors such as the size of the firm.

In addition, the Commission finds that the proposed rule change is consistent with Section 15B(b)(2)(G) of the Act which provides that the MSRB's rules shall prescribe records to be made and kept by municipal advisors and the periods for which such records shall be preserved.<sup>82</sup> The proposed rule change would require each municipal advisor to make and keep all of the general business records described in Exchange Act Rule 15Ba1-8(a)(1)-(8) as well as records of written supervisory procedures and compliance policies, designations of persons as CCO and of persons responsible for supervision, reviews of the adequacy of written compliance policies and written supervisory procedures, the annual certifications as to compliance processes, and, if applicable, annual certifications regarding the exemption for federally regulated fiduciary activities of banks. The proposed rule change also contains preservation requirements for the required records.

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<sup>81</sup> See 15 U.S.C. 78o-4(b)(2)(L)(iv).

<sup>82</sup> See 15 U.S.C. 78o-4(b)(2)(G).



In approving the proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation.<sup>83</sup> The Commission believes the proposed rule change includes accommodations that help promote efficiency such as an exemption for federally regulated banks in proposed Rule G-44(e) and an exemption to the annual certification requirement for municipal advisors that are subject to a substantially similar certification requirement by FINRA.

The Commission believes the proposed rule takes into account competitive concerns that could arise as a result of the costs associated with the supervision and compliance requirements that could lead some municipal advisors to exit the market, curtail their activities or consolidate with other firms. By utilizing a primarily principles-based approach to supervision and compliance, the proposed rule is designed to provide flexibility to small municipal advisor firms, including those with only one associated person, allowing municipal advisors to tailor their supervisory procedures to, among other things, their size, particular business model and structure. Moreover, the Commission continues to believe "that the market for municipal advisory services is likely to remain competitive despite the potential exit of municipal advisors, consolidation of municipal advisors, or lack of new entrants into the market."<sup>84</sup>

The Commission believes that the effect of the proposed rule is beneficial and that the changes will enhance investor confidence by promoting robust supervisory policies and procedures, programs and controls that can be flexibly applied to account for the diversity of the municipal advisor population, including small municipal advisors and sole proprietorships.

As noted above, the Commission received eight comment letters on the filing. The

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<sup>83</sup> 15 U.S.C. 78c(f).

<sup>84</sup> Municipal Advisor Registration Adopting Release, 78 FR 67467, at 67608.

Commission believes that the MSRB, through its responses and through proposed changes in Amendment No. 1, has addressed commenters' concerns.

For the reasons noted above, including those discussed in the MSRB Response Letter and MSRB Amendment Letter, the Commission believes that the proposed rule change, as amended by Amendment No. 1, is consistent with the Act.

V. Solicitation of Comments on Amendment No. 1

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 1 to the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form <http://www.sec.gov/rules/sro.shtml>; or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number

SR-MSRB- 2014-06 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number SR-MSRB-2014-06. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those

that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of the MSRB. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2014-06 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Accelerated Approval of Proposed Rule Change as Modified by Amendment No. 1

The Commission finds good cause for approving the proposed rule change, as amended by Amendment No. 1, prior to the 30th day after the date of publication of notice in the Federal Register. As discussed above, Amendment No. 1 amends the proposed rule change by: (i) revising paragraphs .01 and .02 of the Supplementary Material to Rule G-44 to no longer limit the requirement in paragraph .02 that written supervisory procedures address the manner in which, in the absence of separate supervisory personnel, such procedures are nevertheless reasonably designed to achieve compliance with applicable rules for municipal advisors with a single person and expand its application to apply to all firms with any associated person permitted under applicable law to supervise their own activities and move the text from paragraph .02 or paragraph .01 of the Supplementary Material in light of the revised scope of the provisions; (ii) amending the text of Rule G-44(e) to reference Rule G-8(h)(v)(A)-(E) rather than Rule G-8(h)(iii); and (iii) amending the text of Rule G-9(k) to reference Rule 15Ba1-8(d) under

the Act rather than Rule 15a1-8(d) under the Act.<sup>85</sup>

The MSRB has proposed the revisions included in item (i) of the previous paragraph to expand the applicability of the provision, requiring a municipal advisor's written supervisory procedures to address how its supervision is adequate even without having separate supervisors, to account for instances of self-supervision that may occur in firms that are not sole proprietorships. The MSRB believes the revision more properly identifies and captures the subset of municipal advisors for which the written supervisory procedures must address the additional matter. The MSRB is proposing the two technical revisions in items (ii) and (iii) in the previous paragraph to indicate the correct cross-references.

The Commission believes that Amendment No. 1 does not alter the substance of the original proposed rule change and are consistent with the purpose of the original proposed rule change and do not raise significant new issues. Accordingly, the Commission finds good cause for approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis, pursuant to Section 19(b)(2) of the Act.

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<sup>85</sup> See MSRB Amendment Letter.

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>86</sup> that the proposed rule change (SR-MSRB-2014-06), as modified by Amendment No. 1, be, and hereby is, approved on an accelerated basis.

For the Commission, pursuant to delegated authority.<sup>87</sup>

Kevin M. O'Neill,  
Deputy Secretary.

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<sup>86</sup> 15 U.S.C. 78s(b)(2).

<sup>87</sup> 17 CFR 200.30-3(a)(12).